IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. .....

LORRAINE WILSON AND HULDAH DIEKMANN,
Petitioners,
Appellants below,

vs.

VAN VECHTEN SHAFFER, DON BARNES,
ARTHUR BARLOW, FRANK BYERS,
THE SHORES COMPANY, A CORPORATION, and
SHORES-MUELLER COMPANY, A CORPORATION,
Respondents,
Appellees below.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

The Opinion Below.

The opinion of the United States Circuit Court of Appeals for the Eighth Circuit is reported in 141 Federal Reporter (2nd) 877. The opinion is also printed in full in the record. (R. 75)

Jurisdiction.

The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code, as amended (43 Stat. 938; 28 U.S.C.A. Sec. 347).

The Circuit Court of Appeals has in this case rendered a decision which is, at the same time (1) in conflict with a decision of the Circuit Court of Appeals for the Second Circuit on the same matter (*Bogert* v. *Southern Pacific Company,* 244 F. 61; affirmed on matter in question, 250 U. S. 483, 490, 39 S. Ct. 533; 63 L. Ed. 1099), and (2) probably in conflict with applicable local decisions and other authority, on an important question of general law.

The decision in this case was entered by the United States Circuit Court of Appeals for the Eighth Circuit on April 17, 1944. (R. 85)

Statement of the Case.

Petitioners and others filed their complaint in the District Court alleging a class case by stockholders in their own right (not derivative) against officers and directors of their corporation, claiming a constructive trust in stock of a new corporation formed, and owned, by those officers, and to which they had caused the corporation's business and property to be transferred in breach of trust. The nature of the breach of trust is not material here, but is set forth in the decision of the Circuit Court of Appeals. (R. 75)

Respondents filed a motion to dismiss. As to petitioners, they alleged that this case was barred by former adjudication. This contention was adopted by the District Court, and the Circuit Court of Appeals affirmed on this point. As to the other plaintiffs, respondents moved to dismiss the case as barred by limitations. This, also, was adopted by the District Court, but on this issue the case was reversed and remanded by the Circuit Court of Appeals.

The prior case which has been found to bar petitioners in this case, was filed by petitioners and others in the same

District Court, and arose out of the same factual situation. That case was dismissed on motion, as barred by limitations. (*Wilson* v. *Shores-Mueller Co.*, D.C.N.D.Ia., 40 F. Supp. 729). That case, unlike this case, was derivative, or secondary, in its nature, and really asserted a cause of action running in favor of the corporation and could, if successful, have resulted only in a recovery by the corporation. No personal or primary rights of plaintiffs as stockholders were asserted or could have been decided.

The Circuit Court of Appeals acknowledged the distinction between a class case by stockholders in their own right, and a secondary action by stockholders in the right of the corporation. However, it held that the judgment in the prior case, a derivative case, was a bar to "their claim for a direct personal interest in the constructive trust property * * *."

The fact that the charges of fraud and collusion in the prior case included by implication the charge of breach of trust, and that the case need not have proceeded on the theory of fraud by the officers, is beside the point. Whether for fraud, or simply for breach of trust, it was in legal effect an action by the corporation for a wrong inflicted upon the corporation. The constructive trust there alleged was in favor of the corporation.

The constructive trust alleged in this case is said to arise in favor of plaintiffs because of a wrong done them directly by the defendants. They do not complain of a wrong done to the corporation.

In an analogous case, the United States Circuit Court of Appeals for the Second Circuit held that an adverse decision in a case wherein it was sought to set aside a transaction on the ground of fraud, was not a bar to a subsequent case by stockholders, in their own right, to declare a constructive trust in the fruits of that same transaction. (*Bogert* v. *Southern Pacific Co.*, 244 F. 61).

This Court allowed certiorari to review that decision (245 U.S. 668). Upon review it was affirmed in all respects material to this petition (*Southern Pacific Co.* v. *Bogert,* 250 U.S. 483).

We respectfully submit that the decision of the Circuit Court of Appeals in this case is in direct conflict with the decision of both courts in the case last cited. It was there decided that there was a duty owing by those in control of a corporation, to allow other stockholders to share in "the proceeds of common property," and that a prior unsuccessful case to set the transaction aside did not involve the same equity or amount to a prior adjudication. In this case, the decision is to the contrary; the Circuit Court of Appeals said: "They thereby lost the right to litigate further against defendants their claim for a direct personal interest in the constructive trust property on the basis either of fraud or of violation of fiduciary relationship and duty." (141 F. 2nd, 877, 882). The Court said that despite the fact that it recognized that this case, like the *Bogert* case, was an attempt to follow trust property (if not wholly so, at least in part) and not to set aside the transactions in question and restore the property to the corporation. The prior case was clearly of the latter kind (*Wilson* v. *Shores-Mueller Co.,* 40 F. Supp. 729), and derivative in its nature.

In other words, this Honorable Court, and the Circuit Court of Appeals for the Second Circuit, have held that an action to enforce the stockholders' primary right may be separately prosecuted, whereas the Circuit Court of Appeals for the Eighth Circuit has held in this case that a stockholder must submit all his rights, primary or secondary, when he brings an action.

The question at hand is an important principle of general, or "federal", law and, considering the importance of stockholders' remedies as one of the rapidly evolving

branches of law, it is in the public interest that this Honorable Court review this case, in order to resolve the conflict in decisions and to clarify the law on the subject involved.

Specification of Errors.

If the writ is granted, petitioners will urge that the Circuit Court of Appeals erred in the following respects:

(1) In holding, in effect, that when a stockholder files a case against officers and directors of the corporation for fraud or breach of trust, he cannot split his cause of action, but must submit all his rights, primary and secondary in nature, for equitable relief.

(2) In holding that the prior case involved petitioners' primary rights, which are asserted in this case, arising from breach of fiduciary duty owed directly by the unfaithful officers to the stockholders.

(3) In not holding that the prior case involved secondary or derivative rights only, and did not involve, or adjudicate, petitioners' primary rights and remedies coming to them for wrongs directly inflicted upon them by the unfaithful officers.

(4) In not holding that the only effect of the prior judgment was to decide that petitioners were not personally qualified to institute a derivative suit on behalf of the corporation, which was the only matter actually decided in that former case.

ARGUMENT.

Point I.

The decision of the Circuit Court of Appeals herein is in conflict with the decision of this Court and the Circuit Court of Appeals for the Second Circuit.

The equity claimed in this case (R. 6) is the same as in *Southern Pacific Co.* v. *Bogert*, 244 F. 61; 250 U.S. 483. This Court said in its opinion in that case (pg. 487):

> "In considering the many objections urged against the decree, it is important to bear constantly in mind the exact nature of the equity invoked by the bill and recognized by the lower courts. The minority stockholders do not complain of a wrong done the corporation or of any wrong done by it to them. They complain of the wrong done them directly by the Southern Pacific and by it alone. The wrong consists in its failure to share with them, the minority, the proceeds of the common property of which it, through majority stockholdings, had rightfully taken control. In other words, the minority assert the right to a pro rata share of the common property; and equity enforces the right, by declaring the trust on which the Southern Pacific holds it and ordering distribution or compensation. The rule of corporation law and of equity invoked is well settled and has been often applied. The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors. If through that control a sale of the corporate property is made and the property

acquired by the majority, the minority may not be excluded from a fair participation in the fruits of the sale."

In this case, control of the corporation was in respondents who had voting control under a voting trust agreement and had made themselves directors and officers of the corporation. It is alleged that they contrived a receivership and bought in the corporation's property and business at a grossly inadequate amount. The complaint asserts the following equity (R. 6):

> "23. That through the control of these defendants as trustees for the stockholders of the Shores Mueller Company a sale of the assets of said Company was made and said assets were acquired by these defendants to the exclusion of these plaintiffs and their fellow stockholders in the Shores Mueller Company for whom these defendants were *de facto* and authorized trustees, and that these plaintiffs have been excluded from a fair participation in the fruits of said sale which was executed for an inadequate consideration and in violation of the defendants duties of trust as trustees under the voting trust agreement executed in March of 1931, hereinbefore set out, and as trustees for the stockholders by virtue of their control of (fol. 8) the Shores Mueller Company."

The relief claimed (R. 8) is a pro rata share in the stock of the new corporation which the officers organized to take over the assets and business of the old corporation.

It is therefore clear that this case and the *Bogert* case are analogous, and are both based upon fiduciary duties owed directly to stockholders.

In the *Bogert* case, there had been much previous litigation, including, as in this instant case, an attempt by stock-

holders to set aside the sale. This Court (pg. 490) stated that the theory of the earlier case was "widely at variance" with the case then before the court, and the decision did not, therefore, operate as *res judicata.*

The case at bar is similar in this respect also; the earlier case appealed to another, and very different, equity (R. 32). It was filed in the right of the corporation and sought a recovery by it. The equity claimed in the instant case was not within the theory or principles of that case, and cannot, in justice, be said to have been submitted so as to have been adjudged. Nor were they adjudged in that case. *Wilson* v. *Shores-Mueller Co.*, 40 F. Supp. 729.

The decisions are thus in conflict. This Court, and the Court of Appeals for the Second Circuit, have recognized a separate equity and right to follow trust property, independent of the rights enjoyed derivatively through the corporation, and the Circuit Court of Appeals in this case has refused to recognize this equity, by holding that a judgment in a derivative case is a bar to all rights of any kind, except such incidental benefits as they might receive if other stockholders might be successful in a derivative case for the benefit of the corporation.

The Circuit Court of Appeals confused the issue. They pointed out that the complaint in the first suit, while alleging fraud and conversion, had within it, by implication, a charge of simple breach of trust. That may be true, and we do not seek to litigate that point, at least, at this time. But, granting that, the conclusion of the court does not follow. The fraud or breach of trust which was alleged was a wrong to the corporation. The error of the court lay in holding that a charge of breach of fiduciary duty owed directly to the stockholders (a wrong to them) could be implied in that case, and barred in this one. There also is the conflict, for this Court has refused to raise any such implication.

Point II.

The Circuit Court of Appeals has decided an important question of general, or federal, law in a manner probably in conflict with the weight of authority.

(a) The distinction between a stockholder's secondary action, in behalf of the corporation, (or, at least, in its right) and a stockholders' class case in their own right, is well established as a matter of general law, although not of frequent occurrence.

The following authorities deal with the nature of the derivative, or secondary, case:

Graham v. *Machine Works*, 138 Iowa 456; 114 N. W. 619.

Dillon v. *Lee*, 110 Iowa 156; 81 N. W. 245.

Ontjes v. *MacNider* (S. Ct. Iowa) 5 N. W. 2nd 860.

In re the Van Sweringen Co., 119 Fed. 2nd 231.

These authorities support the contention that stockholders may also have other rights, not derivative in their nature.

Southern Pacific Co. v. *Bogert*, 250 U. S. 483.

Pepper v. *Litton*, 308 U. S. 295.

Dawson v. *National Life Ins. Co.*, 176 Iowa 362; 157 N. W. 929.

Dunnett v. *Arn* (CCA 10th) 71 F. 2nd 912, 918.

Harris v. *Pearsall*, 190 N. Y. S. 61.

Fletcher, Cyclopedia of Corporations, Vol. 13, Sec. 5958.

On principle, a judgment is a case of one class, and in one of those rights, should not constitute a bar to the enforcement of the other.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that this Honorable Court should grant the writ of certiorari and review the decision of the United States Circuit Court of Appeals for the Eighth Circuit in this case.

Respectfully submitted,

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